

JOINT STOCK COMMERCIAL BANK UKRGAZBANK

**Independent Auditors' Report and
Financial Statements for the Years
Ended December 31, 1998 and 1997**

JOINT STOCK COMMERCIAL BANK UKRGAZBANK

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INDEPENDENT AUDITORS' REPORT

To the Shareholders and Board of Directors of
Ukrgazbank Closed Joint Stock Company:

We have audited the accompanying balance sheets of Joint Stock Commercial Bank Ukrgazbank (the “Bank”) as at December 31, 1998 and 1997, and the related profit and loss accounts and statements of cash flows for the years then ended. These financial statements are the responsibility of the Bank’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with International Standards on Auditing. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1 to the financial statements, the Bank has not adopted International Accounting Standard No. 29, “Financial Reporting in Hyperinflationary Economies”, which practice, in our opinion, is not in accordance with International Accounting Standards. The Bank has not determined the effect of not adopting this standard on the financial statements.

In our opinion, except for the effects on the financial statements of the matter referred to in the preceding paragraph, the financial statements present fairly, in all material respects, the financial position of the Bank as at December 31, 1998 and 1997, and the results of its operations and its cash flows for the years then ended in accordance with International Accounting Standards.

As discussed in Note 1 to the accompanying financial statements, the Bank’s current financial condition and future operations could be effected by continued economic difficulties in Ukraine.

Deloitte & Touche

May 12, 1999



JOINT STOCK COMMERCIAL BANK UKRGAZBANK

PROFIT AND LOSS ACCOUNTS FOR THE YEARS ENDED DECEMBER 31, 1998 AND 1997 (in Ukrainian Hryvnias)

	Notes	1998	1997
Interest income		5,281,381	2,055,841
Interest expense		<u>3,014,872</u>	<u>978,134</u>
NET INTEREST INCOME	2	<u>2,266,509</u>	<u>1,077,707</u>
Fee and commission income		3,749,839	3,663,645
Fee and commission expense		(362,161)	(382,616)
Foreign exchange gains, net		1,889,478	76,201
Dealing gains (losses)		49,570	(186,295)
Other income		<u>89,125</u>	<u>91,041</u>
NET NON-INTEREST INCOME		<u>5,415,851</u>	<u>3,261,976</u>
OPERATING INCOME		7,682,360	4,339,683
Operating expenses	3	<u>3,703,728</u>	<u>3,225,217</u>
INCOME BEFORE PROVISION FOR LOSSES AND INCOME TAXES		3,978,632	1,114,466
Provision for losses	4	<u>2,448,354</u>	<u>471,708</u>
INCOME BEFORE INCOME TAXES		1,530,278	642,758
Income taxes	5	<u>217,172</u>	<u>360,505</u>
NET INCOME		<u><u>1,313,106</u></u>	<u><u>282,253</u></u>

See notes to financial statements.

JOINT STOCK COMMERCIAL BANK UKRGAZBANK

BALANCE SHEETS DECEMBER 31, 1998 AND 1997 (in Ukrainian Hryvnias)

	Notes	1998	1997
ASSETS			
Cash and balances with the National Bank of Ukraine	6	18,256,519	7,981,468
Loans and advances to banks, net	7	13,201,158	2,502,971
Dealing securities	8	91,364	409,952
Loans and advances to customers, net	9	8,549,493	3,499,273
Investments, net	10	667,220	-
Fixed assets, net	11	1,415,849	242,489
Other assets		864,722	320,199
TOTAL ASSETS		43,046,325	14,956,352
LIABILITIES AND SHAREHOLDERS' EQUITY			
Loans and advances from banks	12	11,881,129	5,592,655
Customer accounts	13	22,605,624	7,575,885
Other liabilities		667,705	130,563
Total liabilities		35,154,458	13,299,103
COMMITMENTS AND CONTINGENCIES	16		
SHAREHOLDERS' EQUITY:	14		
Share capital		6,974,000	2,300,000
Fixed assets revaluation surplus		277,586	30,074
Retained earnings/(accumulated deficit)		640,281	(672,825)
Total shareholders' equity		7,891,867	1,657,249
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		43,046,325	14,956,352

See notes to financial statements.

JOINT STOCK COMMERCIAL BANK UKRGAZBANK

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 1998 AND 1997 (in Ukrainian Hryvnias)

	Notes	1998	1997
CASH FLOWS FROM OPERATING ACTIVITIES:			
Income before income taxes		1,530,278	642,758
Adjustments for:			
Provision for losses		2,448,354	471,708
Depreciation expense		142,629	14,960
Change in net interest accruals		(132,686)	(191,774)
Operating profit before changes in operating assets and liabilities		<u>3,988,575</u>	<u>937,652</u>
Changes in operating assets and liabilities			
Increase in operating assets:			
Reserve balances with National Bank of Ukraine		(2,974,641)	(1,465,296)
Loans and advances to banks		(11,552,083)	(1,133,516)
Dealing securities		318,588	(365,013)
Loans and advances to customers		(7,089,025)	(442,613)
Other assets		(166,001)	(240,720)
Increase in operating liabilities:			
Loans and advances from banks		6,288,474	4,923,322
Customer accounts		15,029,739	5,230,754
Other liabilities		261,768	62,089
Net cash provided by operating activities before income taxes		<u>4,105,394</u>	<u>7,506,659</u>
Income tax paid		<u>(217,172)</u>	<u>(360,505)</u>
Net cash provided by operating activities		<u>3,888,222</u>	<u>7,146,154</u>
CASH FLOW FROM INVESTING ACTIVITIES			
Purchase of fixed assets		(1,125,074)	(165,505)
Disposals of fixed assets		56,597	-
Purchase of investments		<u>(785,220)</u>	<u>-</u>
Net cash used in investing activities		<u>(1,853,697)</u>	<u>(165,505)</u>
CASH FLOW FROM FINANCING ACTIVITIES			
Share capital issued and registered		4,750,000	-
Share capital issued and not registered		5,000	-
Share capital repurchased		<u>(81,000)</u>	<u>-</u>
Net cash provided by financing activities		<u>4,674,000</u>	<u>-</u>
NET INCREASE IN CASH AND CASH EQUIVALENTS		6,708,525	6,980,649
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	6	<u>7,499,396</u>	<u>518,747</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	6	<u>14,207,921</u>	<u>7,499,396</u>
Non-cash investing activity			
Revaluation of fixed assets		<u>247,512</u>	<u>-</u>

See notes to financial statements.

JOINT STOCK COMMERCIAL BANK UKRGAZBANK

NOTES TO FINANCIAL STATEMENTS FOR THE YEARS ENDED DECEMBER 31, 1998 AND 1997 (in Ukrainian Hryvnias)

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Joint Stock Commercial Bank Ukrgazbank (the “Bank” or “Ukrgazbank”) was legally established as a closed joint stock company on August 22, 1995 under National Bank of Ukraine (“NBU”) license number 183, from the former closed joint stock bank “Hadjibej”. On May 27, 1997 the Bank changed its name from Intergazbank to Ukrgazbank. Subsequently, on October 10, 1997, Ukrgazbank was re-registered with the NBU as an open joint stock company. The Bank’s primary business consists of banking and financial services to commercial and private customers primarily located in Ukraine.

Economic Crisis and Year 2000 Problem

The Commonwealth of Independent States (“CIS”), of which Ukraine is included, is experiencing serious economic instability as a result of an unbudgeted fiscal deficit, high levels of government interest rates, debt and default, low rates of tax collection, a lack of liquidity, and volatile currency and stock markets. Inability on the part of Ukraine and other countries within the CIS to obtain sufficient funds to remedy the situation has caused a significant devaluation of various currencies including the hryvnia, instability of the banking system and other serious economic and political consequences.

The return to economic stability is dependent to a large extent on the efficacy of the fiscal measures taken by the government within Ukraine and other CIS countries and other actions beyond the Bank’s control. The recoverability of the Bank’s assets and the ability of the Bank to maintain or pay its debts as they mature, as well as the future operations of the Bank, may be significantly affected by such severe national economic difficulties.

It is uncertain as to whether the Ukrainian government and other organizations that provide significant infrastructure services have sufficiently addressed the Year 2000 Problem to mitigate disruption of service or an adverse affect on the operations of the Bank. Furthermore, the current economic crisis could also adversely affect the ability of these and other organizations to fund Year 2000 compliance programs. The accompanying financial statements do not include any adjustments that might be necessary as a result of these uncertainties.

The principal accounting policies of the Bank are summarized below:

Accounting basis - The Bank maintains its accounting records in accordance with Ukrainian accounting standards based on the historical cost convention as modified by the revaluation of certain properties and equipment. Effective January 1, 1998, the NBU issued instructions introducing accounting reforms to the banking sector. These reforms have introduced accounting principles that are closer in line with International Accounting Standards (“IAS”). These financial statements have been prepared from these accounting records and have been adjusted to conform with IAS, except that IAS No. 29 has not been adopted.

The preparation of the financial statements in conformity with IAS requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates. Estimates that are particularly susceptible to change relate to the provision for loan losses and the fair value of financial instruments.

Ukraine experienced high levels of inflation during 1998 and several preceding years. Under IAS No. 29, "Financial Reporting in Hyperinflationary Economies", the accompanying financial statements should be adjusted to reflect the effects of the diminution of the purchasing power of the hryvnia. These adjustments have not been made, and the effects on the accompanying financial statements of not adopting this standard have not been determined.

Reporting currency - The currency used in these financial statements is the Ukrainian hryvnia, which is denoted by the symbol "UAH".

Provisions for loan losses - The provision for loan losses is based on an analysis of the loan portfolio and reflects the amount which, in the judgment of management, is adequate to provide for losses inherent in the loan portfolio.

Specific provisions are made as a result of a detailed appraisal of risk assets. In addition, general provisions are carried to cover risks which, although not specifically identified, are present in any portfolio of banking assets. The total increase in the allowance for loan losses is recorded in the profit and loss accounts and the total of such provisions is deducted in arriving at the balance sheet figures of loans and advances to banks and customers. Management's evaluation of the allowance is based on the Bank's known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral and current economic conditions. Estimates of loan losses involve an exercise of judgment. While it is possible that in particular periods the Bank may sustain losses which are substantial relative to the provision for loan losses, it is the judgment of management that the provision for loan losses is adequate to absorb losses inherent in the loan portfolio.

Non-accrual loans - Loans are placed on non-accrual status when interest or principal is delinquent in excess of 90 days except when all amounts are fully secured by cash or marketable securities and collection proceedings are in process. Interest is not taken to profit when recovery is doubtful.

Cash and cash equivalents - For purpose of the statement of cash flows, the following are considered to be cash and cash equivalents: cash, unrestricted balances with the NBU, and correspondent accounts with banks in countries included in the Organization for Economic Cooperation and Development ("OECD"). Cash equivalents are considered to be short-term, highly liquid investments that are readily convertible to known amounts of cash. The minimum reserve deposit required by the NBU is not included as a cash equivalent due to restrictions on its availability (note 6).

Dealing securities - Dealing securities are stated at amortized cost which approximates market value.

Investments - Investments in subsidiaries are consolidated only when they are significant and control is not intended to be temporary. Investments in associated companies that are significant are accounted for using the equity method. All subsidiaries and associates that have an insignificant effect on the financial statements and all other investments are stated at the lower of cost or market.

Depreciation - Depreciation on the revalued amount of fixed assets is designed to write off assets over their useful economic lives and is calculated on a straight line basis at the following annual prescribed rates:

Buildings and improvements	2%
Furniture, vehicles and equipment	10-20%
Other	33%

Foreign currencies - Assets and liabilities denominated in foreign currencies are translated at the appropriate spot rates of exchange ruling at the balance sheet date. Profits and losses arising from this translation are included in the accompanying profit and loss accounts. The exchange rates used by the Bank in the preparation of the financial statements are as follows:

	1998	1997
UAH/USD	3.427000	1.899000
UAH/DEM	2.048416	1.059700

Concentration of business risk – Laws and regulations affecting businesses operating in Ukraine are subject to rapid change and the Bank’s assets and operations could be at risk due to negative changes in political and business environment. The Bank’s activities are predominantly in Ukraine.

Income taxes - The Bank determines income tax expense using the liability method of accounting for income taxes. Under the liability method, the expected tax effects of temporary differences are determined and reported as deferred tax assets or liabilities. Deferred tax assets are recorded to the extent that there is a reasonable expectation that the assets will be realized. During 1998, the base profit tax rate in Ukraine for banks was 30%.

Reclassifications - Certain amounts in the 1997 financial statements have been reclassified to conform with the 1998 presentation.

2.	NET INTEREST INCOME	1998	1997
	Interest income		
	Loans and advances to banks	721,949	316,794
	Loans and advances to customers	2,808,003	1,710,607
	Treasury bills and other securities	1,751,429	28,440
	Total interest income	<u>5,281,381</u>	<u>2,055,841</u>
	Interest expense		
	Loans and advances from banks	1,871,415	648,828
	Customer accounts	1,143,457	329,306
	Total interest expense	<u>3,014,872</u>	<u>978,134</u>
	Net interest income	<u>2,266,509</u>	<u>1,077,707</u>
3.	OPERATING EXPENSES	1998	1997
	Staff costs	1,471,109	615,007
	Taxes other than income tax	299,729	86,205
	Charity	261,142	-
	Advertizing	220,665	293,002

Leasing costs	33,609	993,292
Communication	213,390	62,012
Depreciation	142,629	14,960
Other	<u>1,061,455</u>	<u>1,160,739</u>
	<u>3,703,728</u>	<u>3,225,217</u>

4. PROVISION FOR LOSSES

Provisions on loans and advances to banks (note 7)	262,011	22,818
Provisions on loans and advances to customers (note 9)	2,038,805	448,890
Provisions on investments (note 10)	118,000	-
Provisions on guarantees (note 16)	29,538	-
	<u>2,448,354</u>	<u>471,708</u>

5. INCOME AND OTHER TAXES

Ukrainian corporation tax is levied at a rate of 30% on income less allowable expenses. Tax liabilities calculated in accordance with Ukrainian tax laws may differ significantly from amounts calculated based on IAS income and expense.

Ukraine currently has a number of laws related to various taxes imposed by both national and regional governmental authorities. Applicable taxes include value added tax, corporate income tax (profits tax), a number of turnover based taxes/ and payroll (social) taxes, together with others. Laws related to these taxes have not been in force for significant periods, in contrast to more developed market economies; therefore, implementing regulations are often unclear or nonexistent. Accordingly, few precedents with regard to issues have been established. Often, differing opinions regarding legal interpretation exist both among and within government ministries and organizations (like the Tax Administration and its various inspectorates), thus creating uncertainties and areas of conflict. Tax declarations, together with other legal compliance areas (as examples, customs and currency control matters) are subject to review and investigation by a number of authorities, who are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax risks in Ukraine substantially more significant than typically found in countries with more developed tax systems.

Generally, tax declarations remain open and subject to inspection for an indefinite period of time. However, in practice the risk of retroactive tax assessments and penalty charges decreases significantly after three years. The fact that a year has been reviewed does not close that year, or any tax declaration applicable to that year, from further review.

Management believes that the Bank is in substantial compliance with the tax laws affecting its operations; however, the risk remains that relevant authorities could take differing positions with regard to interpretive issues and the effect could be significant.

	1998	1997
Income before provision for income taxes	<u>1,530,278</u>	<u>642,758</u>
Tax at the statutory tax rate of 30%	459,083	192,827
Tax effect of adjustments required in determining taxable profit:		
Non-deductible expenses	277,267	225,511
Tax exempt income	(372,420)	(8,532)
Change in valuation allowance	<u>(146,758)</u>	<u>(49,301)</u>
Provision for income taxes	<u>217,172</u>	<u>360,505</u>

Deferred tax assets of UAH 266,149 and UAH 343,379 as of December 31, 1998 and 1997, respectively, were not recorded due to the uncertainty of both future taxable income and the changing Ukrainian statutory tax regulations.

The deferred asset not recognized comprises the following:

	1998	1997
Allowance for loans and advances to banks	85,817	6,845
Allowance for loans and advances to customers	87,432	285,924
Allowance for equity investments	35,400	9,067
Allowance for guarantees	8,861	-
Accrued expenses not recognized per statutory accounts	48,639	41,543
	<u>266,149</u>	<u>343,379</u>
Deferred tax thereon at 30%		

6. CASH, CASH EQUIVALENTS AND BALANCES WITH THE NATIONAL BANK OF UKRAINE

The Bank is required to maintain obligatory minimum cash resources with the NBU. The minimum reserve deposits were computed based on the balance of demand and deposit accounts in accordance with NBU regulations. The Bank met the NBU minimum requirements as at December 31, 1998 and 1997, which amounted to UAH 4,781,549 and UAH 1,806,908, respectively.

Cash and cash equivalents as presented in the preparation of the statements of cash flows include the following:

	1998	1997
Cash on hand	1,299,368	865,470
Balances with the NBU	16,957,151	7,115,998
Advances to OECD banks (included in Note 7)	732,951	1,324,836
	<u>18,989,470</u>	<u>9,306,304</u>
Less restricted balance with the NBU	4,781,549	1,806,908
	<u>14,207,921</u>	<u>7,499,396</u>
Total cash and cash equivalents		

7. LOANS AND ADVANCES TO BANKS

	1998	1997
Advances to banks	765,271	1,380,256
Loans to banks	12,721,942	1,146,759
	<u>13,487,213</u>	<u>2,527,015</u>
Less allowance for loan losses	286,055	24,044
	<u>13,201,158</u>	<u>2,502,971</u>

Analysis of the allowance for loan losses

Specific provision at beginning of year	-	-
Provision for the year	30,970	-
	<u>30,970</u>	<u>-</u>
Specific provision at end of year		
General provision at beginning of year	24,044	1,226
Provision for the year	231,041	22,818
	<u>255,085</u>	<u>24,044</u>
General provision at end of year		
Total allowance for loan losses	<u>286,055</u>	<u>24,044</u>

8. DEALING SECURITIES	1998	1997
Ukrainian government treasury bills	91,364	298,452
Other	-	111,500
	<u>91,364</u>	<u>409,952</u>

Treasury bills held by the Bank are recorded at cost as of December 31, 1998 and 1997. These bills pay no interest and so are traded at a discount to their nominal value. Income is recognized as discount amortization over the life of the bills and the nominal value is repaid on maturity.

9. LOANS AND ADVANCES TO CUSTOMERS

	1998	1997
Analysis by security		
Loans collateralized by guarantees	716,152	1,412,077
Loans collateralized by real estate	2,170,260	2,211,035
Loans collateralized by other collateral	4,898,712	364,134
Unsecured	4,192,507	901,360
	<u>11,977,631</u>	<u>4,888,606</u>
Less allowance for loan losses	3,428,138	1,389,333
	<u>8,549,493</u>	<u>3,499,273</u>

Analysis of the allowance for loan losses

General provision at beginning of year	244,430	211,273
Provision for the year	500,365	33,157
	<u>744,795</u>	<u>244,430</u>
General provision at end of year	744,795	244,430
Specific provision at beginning of year	1,144,903	729,170
Provision for the year	1,538,440	415,733
	<u>2,683,343</u>	<u>1,144,903</u>
Specific provision at end of year	2,683,343	1,144,903
Total allowance for loan losses	<u>3,428,138</u>	<u>1,389,333</u>

Analysis by sector

Trading and catering companies	3,247,000	1,048,558
State bodies	2,119,034	-
Forestries	942,542	-
Agriculture	707,300	1,173,650
Consumer loans	3,039,176	890,477
Other	1,922,579	1,775,921
	<u>11,977,631</u>	<u>4,888,606</u>
Less allowance for loan losses	3,428,138	1,389,333
	<u>8,549,493</u>	<u>3,499,273</u>

As at December 31, 1998 and 1997, all loans and advances were given to the customers within Ukraine. The Bank is not exposed to any particular borrower due to the fact that as at December 31, 1998 there was only one loan amounting to UAH 1,100,000 that exceeded 10% of the Bank's shareholders' equity.

Included in the loans to customers are non-accrual loans of UAH 3,355,679 and UAH 1,303,119 as at December 31, 1998 and 1997, respectively. As of December 31, 1998 and 1997, loans to customers granted at lower than market interest rates were UAH 2,898,209 and UAH 1,401,701, respectively.

10. INVESTMENTS

	1998	1997
Non-consolidated subsidiary	18,000	-
Investments in associated companies	286,480	-
Promissory notes	151,000	-
Other investments	329,740	-
	<u>785,220</u>	<u>-</u>
Less allowance for losses	118,000	-
	<u>667,220</u>	<u>-</u>

All investments of the Bank are stated at the lower of cost or market. The allowance for investment losses is comprised of specific reserves.

Other investments include the Bank's minority shareholding in one Ukrainian manufacturing company that was recorded within dealing securities in 1997 in the amount of UAH 108,000. In 1998, management of the Bank reclassified this investment from dealing securities into investments at its net fair value at the time of transfer. The resulting diminution in value of these securities of UAH 96,000 is reflected in dealing gains (losses) in the profit and loss account.

Promissory notes represent debt securities issued by the Bank's second largest shareholder, Inter-Invest-Consulting, to finance the purchase of shares in the research institute Element, an entity in which the Bank controls 29% of the shares. Combined shareholding of the Bank and Inter-Invest-Consulting amounts to 58% of Element's shares.

11. FIXED ASSETS

	1998			
	Buildings and Improvements	Furniture, Vehicles and Equipment	Other	Total
At cost				
At January 1, 1998	-	250,950	18,515	269,465
Additions	371,781	744,297	8,996	1,125,074
Disposals	-	59,188	-	59,188
Revaluation	247,512	-	-	247,512
	<u>619,293</u>	<u>936,059</u>	<u>27,511</u>	<u>1,582,863</u>
At December 31, 1998				
Accumulated depreciation				
At January 1, 1998	-	23,692	3,284	26,976
Depreciation expense	4,451	129,620	8,558	142,629
Disposals	-	2,591	-	2,591
Revaluation	-	-	-	-
	<u>4,451</u>	<u>150,721</u>	<u>11,842</u>	<u>167,014</u>
At December 31, 1998				
Net book value				
At December 31, 1998	<u>614,842</u>	<u>785,338</u>	<u>15,669</u>	<u>1,415,849</u>

	Furniture, Vehicles and Equipment	Other	1997 Total
At cost			
At January 1, 1997	92,544	11,416	103,960
Additions	158,406	7,099	165,505
Disposals	-	-	-
Revaluation	-	-	-
	<u>250,950</u>	<u>18,515</u>	<u>269,465</u>
Accumulated depreciation			
At January 1, 1997	12,016	-	12,016
Depreciation expense	11,676	3,284	14,960
Disposals	-	-	-
Revaluation	-	-	-
	<u>23,692</u>	<u>3,284</u>	<u>26,976</u>
Net book value			
At December 31, 1997	<u>227,258</u>	<u>15,231</u>	<u>242,489</u>

12. LOANS AND ADVANCES FROM BANKS

	1998	1997
Advances from banks	11,881,129	4,448,031
Loans from banks	<u>-</u>	<u>1,144,624</u>
	<u>11,881,129</u>	<u>5,592,655</u>

At December 31, 1998, advances from banks are comprised of the balances on the correspondent accounts of two Baltic banks that creates significant concentration risk.

13. CUSTOMER ACCOUNTS

	1998	1997
Demand accounts	19,507,124	5,112,966
Term deposits	<u>3,098,500</u>	<u>2,462,919</u>
	<u>22,605,624</u>	<u>7,575,885</u>

At December 31, 1998, 86% of customer accounts relates to seven customers that creates significant concentration risk.

14. SHAREHOLDERS' EQUITY

At December 31, 1998 and 1997, the Bank's share capital comprised the following amount of ordinary shares, each having a nominal value of UAH 10.

	1998	1997
Authorized and issued shares	705,000	230,000
Authorized, issued and fully paid shares	697,400	230,000

At December 31, 1998 and 1997 share capital as reported on the Balance Sheet comprised of:

Share capital subscribed and registered	7,050,000	2,300,000
Share capital subscribed but not registered	5,000	-
Treasury shares	<u>(81,000)</u>	<u>-</u>
Share capital	<u>6,974,000</u>	<u>2,300,000</u>

Movements in shareholders' equity accounts for the years ended December 31, 1998 and 1997 were as follows:

Share capital

At beginning of year	2,300,000	2,300,000
Share capital issued during the year	<u>4,750,000</u>	<u>-</u>
	<u>7,050,000</u>	<u>2,300,000</u>

Fixed assets revaluation surplus

At beginning of year	30,074	30,074
Revaluation of fixed assets	<u>247,512</u>	<u>-</u>
Fixed assets revaluation surplus at end of year	<u>277,586</u>	<u>30,074</u>

Retained earnings/Accumulated deficit

At beginning of the year	(672,825)	(955,078)
Net income	<u>1,313,106</u>	<u>282,253</u>
Retained earnings/(accumulated deficit)	<u>640,281</u>	<u>(672,825)</u>

15. REGULATORY MATTERS

The Bank is subject to various prescriptive normative ratios as defined by the NBU. As at December 31, 1998 and 1997, the Bank is in compliance with the minimum requirements as set by the NBU. In addition, the Bank is subject to regulatory capital requirement and certain other defined ratios administered by international banking agencies to maintain accreditation with such agencies.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (as set forth in table below) of total and tier 1 capital (as defined) to risk weighted assets. Management believes, as of December 31, 1998 and 1997, that the Bank meets all capital adequacy requirements to which it is subject.

The Bank's actual capital amounts and ratios are presented in the following table:

Capital amounts and ratios	Actual	For Capital Adequacy Purposes	Ratio for capital Adequacy Purposes	Minimum Required Ratio
	Amount in UAH	Amount in UAH		
As of December 31, 1998				
Total capital	7,891,867	8,081,678	51.9%	8%
Tier 1 capital	7,609,281	7,609,281	48.8%	4%
As of December 31, 1997				
Total capital	1,657,249	1,715,675	36.7%	8%
Tier 1 capital	1,627,175	1,627,175	34.8%	4%

16. COMMITMENTS AND CONTINGENCIES

In the normal course of business various commitments and contingent liabilities are outstanding which are not reflected in the accompanying balance sheets.

At December 31, 1998, the Bank had issued guarantees totaling UAH 1,476,898. All guarantees outstanding as at December 31, 1998 were not secured and a general provision amounting to UAH 29,538 against these exposures was recorded. General provision was recorded as a part of other liabilities.

No material commitments for capital expenditures were outstanding at December 31, 1998.

There were no open forward exchange contracts, interest rate or currency swap agreements as at December 31, 1998.

17. RELATED PARTY TRANSACTIONS

At December 31, 1998 and 1997, the Bank had loans totaling UAH 1,797,325 and UAH 663,795, respectively, to shareholders and related parties. At December 31, 1998 and 1997, loans to shareholders and related parties granted at lower than market rates were UAH 597,325 and UAH 543,548, respectively. The interest rate on such loans was 5% and 10% as at December 31, 1998 and 1997, respectively. The Bank also held a deposit of UAH 0 and UAH 808,000 as at December 31, 1998 and 1997, respectively, from a single related party. Interest income on loans to related parties in 1998 and 1997 amounted to UAH 176,692 and UAH 88,203, respectively. Interest expense on related parties' deposits in 1998 and 1997 amounted to UAH 0 and UAH 248,992, respectively.

18. PENSIONS AND RETIREMENT PLANS

Employees receive pension benefits from the Ukrainian government in accordance with the laws and regulations of Ukraine. As at December 31, 1998 and 1997, the Bank was not liable for any supplementary pensions, post-retirement health care, insurance benefits, or retirement indemnities to its current or former employees.

19. FAIR VALUE OF FINANCIAL INSTRUMENTS

Estimated fair value disclosures of financial instruments is made in accordance with the requirements of IAS 32. As no readily available market exists for a large part of the Bank's financial instruments, judgement is necessary in arriving at fair value, based on current economic conditions and specific risks attributable to the instrument. The estimates presented herein are not necessarily indicative of the amounts the Bank could realize in a market exchange from the sale of its full holdings of a particular instrument.

At December 31, 1998 and 1997 the following methods and assumptions were used by the Bank to estimate the fair value of each class of financial instrument for which it is practicable to estimate such value:

Cash and balances with the National Bank of Ukraine - For these short-term instruments the carrying amount is a reasonable estimate of fair value.

Dealing securities – As set out in Note 8, debt securities held by the Bank are stated at cost and adjusted for accretion and amortization of premiums and discounts, respectively, less any provision for permanent diminution in value. As shown in Note 20, these securities have maturities ranging from three months to less than one year.

In the absence of liquid markets for these instruments, it is not possible to determine a precise fair value. However, it is management's intention to hold these securities until maturity, which as described above is short-term.

Loans and advances to banks - For these assets, the carrying amount is a reasonable estimate of fair value.

Loans and advances to customers - The fair value of the loan portfolio is based on the credit and interest rate characteristics of the individual loans within each sector of the portfolio. The estimation of the provision for loan losses includes consideration of risk premiums applicable to various types of loans based on factors such as the current situation of the economic sector in which each borrower operates, the economic situation of each borrower and guarantees obtained. Accordingly, the provision for loan losses is considered a reasonable estimate of the discount required to reflect the impact of credit risk.

Investments - Unlisted securities are stated at cost unless there has been any permanent diminution in value. Market quotes are not available for these securities.

Loans and advances from banks - The carrying amount is a reasonable estimate of fair value.

Customer accounts - The carrying amount is a reasonable estimate of fair value.

20. MATURITY ANALYSIS

1998

	Up to 1 month	1 to 3 months	3 months to 1 year	1 year to 5 years	Over 5 years	Allowance for losses	Total
ASSETS							
Loans and advances to banks, net	13,487,213	-	-	-	-	(286,055)	13,201,158
Dealing securities	-	-	91,364	-	-	-	91,364
Loans and advances to customers, net	1,537,346	6,001,665	4,438,620	-	-	(3,428,138)	8,549,493
Interest earning assets	<u>15,024,559</u>	<u>6,001,665</u>	<u>4,529,984</u>	<u>-</u>	<u>-</u>	<u>(3,714,193)</u>	<u>21,842,015</u>
Cash and balances with the National Bank of Ukraine	18,256,519	-	-	-	-	-	18,256,519
Investments, net	317,740	-	-	467,480	-	(118,000)	667,220
Fixed assets, net	-	-	-	-	1,415,849	-	1,415,849
Other assets	864,722	-	-	-	-	-	864,722
TOTAL ASSETS	<u>34,463,540</u>	<u>6,001,665</u>	<u>4,529,984</u>	<u>467,480</u>	<u>1,415,849</u>	<u>(3,832,193)</u>	<u>43,046,325</u>
LIABILITIES AND SHAREHOLDERS' EQUITY							
Loans and advances from banks	11,881,129	-	-	-	-	-	11,881,129
Customer accounts	19,507,124	244,865	2,853,635	-	-	-	22,605,624
Interest bearing liabilities	<u>31,388,253</u>	<u>244,865</u>	<u>2,853,635</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>34,486,753</u>
Other liabilities	424,681	243,024	-	-	-	-	667,705
Share capital	-	-	-	-	6,974,000	-	6,974,000
Fixed assets revaluation surplus	-	-	-	-	277,586	-	277,586
Retained earnings	-	-	-	-	640,281	-	640,281
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	<u>31,812,934</u>	<u>487,889</u>	<u>2,853,635</u>	<u>-</u>	<u>7,891,867</u>	<u>-</u>	<u>43,046,325</u>
Interest Rate Sensitivity Gap	<u>(16,363,694)</u>	<u>5,756,800</u>	<u>1,676,349</u>	<u>-</u>	<u>-</u>		
Cumulative Interest Rate Sensitivity Gap	<u>(16,363,694)</u>	<u>(10,606,894)</u>	<u>(8,930,545)</u>	<u>(8,930,545)</u>	<u>(8,930,545)</u>		
Cumulative Interest Rate Sensitivity Gap as a Percentage of Total Assets	<u>(38%)</u>	<u>(25%)</u>	<u>(21%)</u>	<u>(21%)</u>	<u>(21%)</u>		

The majority of the Bank's interest earning assets and interest bearing liabilities are at fixed rates of interest. The maturity of the loan portfolio as presented above shows the remaining period from the balance sheet date to the contractual maturity. Long term loans are generally not available in Ukraine, however many short-term loans are granted with the expectation of renewing the loans at maturity. Accordingly, the effective maturity of the loan portfolio may be longer than indicated by the analysis based on the contractual terms.

21. CURRENCY ANALYSIS

1998

	UAH	USD	DEM	Other	Allowance for losses	Total
ASSETS						
Cash and balances with the National Bank of Ukraine	18,042,114	180,565	16,541	17,299	-	18,256,519
Loans and advances to banks, net	12,721,940	583,613	149,339	32,321	(286,055)	13,201,158
Dealing securities	91,364	-	-	-	-	91,364
Loans and advances to customers, net	10,521,038	1,456,593	-	-	(3,428,138)	8,549,493
Investments, net	785,220	-	-	-	(118,000)	667,220
Fixed assets, net	1,415,849	-	-	-	-	1,415,849
Other assets	802,099	62,623	-	-	-	864,722
TOTAL ASSETS	44,379,624	2,283,394	165,880	49,620	(3,832,193)	43,046,325
LIABILITIES AND SHAREHOLDERS' EQUITY						
Loans and advances from banks	11,873,567	-	-	7,562	-	11,881,129
Customer accounts	22,022,081	581,169	2,272	102	-	22,605,624
Other liabilities	445,826	221,879	-	-	-	667,705
Share capital	6,974,000	-	-	-	-	6,974,000
Fixed assets revaluation surplus	277,586	-	-	-	-	277,586
Retained earnings	640,281	-	-	-	-	640,281
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	42,233,341	803,048	2,272	7,664	-	43,046,325